

## **THE MISSING ELEMENT IN DIGITAL COOPERATION BETWEEN JAPAN AND THE UNITED STATES**

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**Marcin Socha**

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### **SUMMARY**

The brief takes a closer look at cooperation initiatives between the United States and Japan in digital technologies. Both countries seem to focus on jointly coordinating efforts to develop 5G and 6G projects. Recent actions taken by the Chinese government, which has been cracking down on cryptocurrency trading, are a clear sign that Beijing is preparing the ground for introducing a digital yuan currency. Joe Biden's administration has recently been debating whether the Chinese digital currency initiative can become a threat to the global supremacy of the US dollar. As of yet, there are no apparent signs of cooperation between Japan and the United States, although the issue of introducing a Central Bank Digital Currency (CBDC) has been receiving a lot of media coverage. Recent developments show that institutional players in Japan and the United States have finally decided to move faster on developing research on a CBDC. One can also observe that Japanese institutions (in this case the Bank of Japan) are looking at what is happening in the United States and are emulating the same cautious position on a CBDC.

## RECOMENDATIONS

1. The European Union should closely monitor recent developments in the U.S.-Japan digital cooperation and, if possible, participate in a digital currency dialogue.
2. The European Union should closely observe the development of CBDC policies in China, the United States and Japan.
3. Experiences of Japan and the United States in areas such as cryptocurrency regulation and ensuring the security of digital transactions should be considered in research regarding the development of European digital currencies.
4. European financial institutions should remain cautious but open-minded towards the idea of introducing alternative digital currencies and work together with the business and banking sectors.

## INTRODUCTION

The United States and Japan have been perceived as global leaders in innovation, revolutionary investment ideas and business. Today one can find several aspects of technological development in which the United States and Japan are visibly falling behind China. One of these is the race for obtaining a digital currency. Recent statements show that institutional players in Japan and the United States have finally decided to move more rapidly on developing research on Central Bank Digital Currencies (CBDCs). During a summit meeting in April 2021, Japan and the United States stated that China was the main security threat on many diplomatic levels in the Asia-Pacific region. At the same time, both countries introduced a draft of a new technology cooperation strategy: the US-Japan Partnership for Competitiveness and Resilience (CoRe), which focuses mainly on developing joint 5G/6G projects. Although the introduction of this new platform of digital cooperation between the United States and Japan looks promising, it seems that there are several elements that are missing. One such element is the ongoing race to introduce digital currencies. In this context, a question which arises is can we expect more overt

teamwork between these two players via existing platforms? Another issue is how to frame cooperation in the context of China's digital currency development program? Finally, how should the European Union respond to ongoing changes?

### THE CRYPTOCURRENCY MARKET AND STRATEGIC DIGITAL ISSUES

Cryptocurrencies have been popular in Japan since the inception of blockchain technology. Along with the dramatic increase in the value of Bitcoin and other leading digital currencies, the Japanese crypto-asset market's value has also seen some spectacular growth. Japan was one of the first countries to introduce cryptocurrency regulations and define the legal term of crypto asset. As a result of favourable regulations and growing interest in cryptocurrencies, Japan has now become the world's largest hub for crypto exchange.

In the United States, interest in cryptocurrencies has not been so evident. Polling found that in 2020 only 6% of Americans owned cryptocurrencies, and 68% said they were not interested in acquiring crypto assets in the future. In 2021, the general public's attitude had changed significantly, with 46% of Americans saying that they own cryptocurrencies with almost 95% believing that crypto exchanges in the USA are a real alternative to traditional currencies.<sup>1</sup>

**From a strategic perspective, Japan and the United States are latecomers in initiating discussion on releasing CBDCs. The actions taken by policymakers in the US and Japan have so far appeared to have been rather reactive.**

But the race continues apace as there are several reasons for growing interest among central banks in developing CBDCs.

One reason is the fear of being left behind in the global digital race. The Atlantic Council survey shows that 70 countries around the world are developing digital currency projects.<sup>2</sup> The most important push has come from China which started experimenting with digital yuan in several cities. Chinese efforts to introduce and distribute this new currency are now of strategic importance.<sup>3</sup> According to Robert Farley, assistant professor at the Patterson School of Diplomacy and International Commerce, Chinese

companies are starting to dominate the Fintech industry, and China's new digital currency project "will extend and deepen that dominance".<sup>4</sup> Beijing has recently stepped-up efforts to develop and regulate digital currency projects. In the long term, such a policy can undermine the global supremacy of the US dollar and expand China's global influence.

Another reason for central banks' increasing focus on CBDCs, is to counter the rise of cryptocurrencies which are outside a country's control and could destabilize the financial market. In recent months, the market value of Bitcoin, Ethereum and other cryptocurrencies had exceeded one trillion US dollars, before experiencing a massive drop in value.<sup>5</sup> Developing official digital currencies or supporting more predictable forms of payments like stable coins may provide a viable alternative for people willing to invest in digital assets and bring them under the control of financial institutions. The latest developments seen in China show that developing an official CBDC would be followed by restricting the use of other crypto assets.

Federal institutions in the United States were very cautious in accepting the idea of a CBDC. Washington had little incentive to develop a digital currency. One reason for this is the domination of the US dollar in global transactions. A similar situation could be observed in Japan. The Bank of Japan (BOJ) has expressed interest in experimenting with its digital currency, but at the same time, remains sceptical about the idea of granting digital currencies a full and legitimate status. Under Japanese law, "Crypto Asset" is not treated as "money" or government-issued currency. Not a single Crypto Asset is officially supported by the Japanese government or the BOJ. Recent developments show that institutions in the United States and Japan have decided to speed up discussions on introducing digital currencies.

#### DIGITAL YUAN AS A STRATEGIC CHALLENGE FOR THE US-JAPAN ALLIANCE

**Joe Biden's administration has recently expressed concerns that the digital yuan can threaten the supremacy of the US dollar in global financial markets and undermine its role as the dominant reserve currency.**

A working group of officials from the Treasury, State Department, Pentagon and National Security Council is discussing the potential implications that the introduction of a digital

currency would have on the global financial order. For example, digital currencies could also be used to work around US sanctions.<sup>6</sup> Although Biden's administration has not signalled any intention of taking any direct measures against Chinese digital currency plans, the threat has garnered more attention from government officials and Members of Congress.

If we take a look at Japan, it seems that the experts and decision-making bodies are not rattled by the recent developments related to the digital yuan. According to BOJ representatives, it is very unlikely that the digital yuan will be a serious competitor to the US dollar. Before such a threat could materialize, the Chinese digital currency would in all probability be pushed out by the digital dollar, which is likely to appear in the next few years. BOJ experts are also predicting that digital currencies' popularisation will prove that some of the current models of distributing digital yuan will become obsolete.<sup>7</sup> The BOJ admits, however that one of the main reasons behind its growing interest in a CBDC is the need to understand what is currently happening in the Chinese financial markets.

#### U.S.-JAPAN DIGITAL COOPERATION PLATFORMS?

**It seems that competition from China and the growing size of the cryptocurrency market are pushing institutions in the US and Japan into action.**

Another driving factor for possible cooperation is the global increase in the number of cashless payments due to COVID-19. In recent months, one could observe several changes, which may imply that the governments in Washington and Japan are trying to accelerate research and development regarding digital currencies.

In February 2021, Treasury Secretary Janet Yellen and Federal Reserve Chairman Jerome Powell stated that "a digital dollar is a high-priority project for the US."<sup>8</sup> In March 2021, the Federal Reserve Bank of Boston and the Massachusetts Institute of Technology decided to speed up their research and create prototypes for a Fedcoin platform, which could be transformed into an official US digital currency.<sup>9</sup> The decision created confusion among American banks, afraid that the introduction of the digital dollar could have a detrimental effect on their bottom line.

However, part of the financial sector is supporting the idea of introducing a digital dollar. A non-profit organization, the Digital Dollar Project, presented plans for launching five pilot programs over the next 12 months to test the feasibility of a digital central bank currency in the United States. The initiative, which is funded by Accenture Plc., is aimed at helping Federal institutions in acquiring data about existing digital currency projects.<sup>10</sup> Federal Reserve Chair, Jerome Powell, stated that the Federal Reserve Board "will issue a discussion paper this summer outlining our current thinking on digital payments, with a particular focus on the benefits and risks associated with CBDC in the US context"<sup>11</sup>. It seems that the United States government is intent on pushing on with research on digital currencies.

As for Japan, the Central Bank has not yet decided whether it will introduce a CBDC.<sup>12</sup> In March 2021, the central bank established the Liaison and Coordination Committee on Central Bank Digital Currency, which acts as a platform for exchanging information between banking and private institutions.<sup>13</sup> The BOJ has also recently launched digital currency trials. The project aims to develop a test environment for a CBDC, which would answer most of the technical questions about the issuance and distribution of a digital currency on a large scale.<sup>14</sup>

Japanese business and private banking sector are much more eager to develop digital currencies than the country's central institutions. In November 2020, two Japanese banks MUFG and SMBC, formed a consortium with 38 Japanese companies to develop research on introducing a digital currency in Japan<sup>15</sup>. There are several benefits of adopting a CBDC. One such advantage is speeding up the process of shifting towards a cashless society. Unfortunately, Japan has one of the world's lowest rates in the number of digital payments. This is illustrated by the fact that in 2019, cash accounted for 73.3% of the country's overall volume of payments<sup>16</sup>. Japanese consumers remain committed to managing transactions in cash because of cultural reasons and social changes brought on by an ageing society. They are therefore not likely to support the idea of switching to a digital currency.

The United States government is pushing its allies to present a unified position on shared values and human rights, presenting China as the main security threat in the region.

**Joe Biden's administration is working to rebuild security alliances in the Asia-Pacific through regional platforms such as QUAD. At the same time, Washington is attempting to promote the idea of establishing digital and technological partnerships in the Asia-Pacific region.**

The recently introduced US-Japan Partnership for Competitiveness and Resilience (CoRe) can mobilize the two countries to work together in the ongoing digital race. Unfortunately, it does not mention cooperating on digital currencies.

In the technological innovation sector, focus has predominantly been put on cooperation in 5G network development, by supporting innovation and promoting "trusted suppliers" in international markets. Also worth noting is the joint research project on 6G technology<sup>17</sup>. The governments in Tokyo and Washington will establish a cooperative research and development fund with a total value of \$4.5 billion.

The initiative, which focuses primarily on developing cooperation in 5G technology, is aimed at challenging the increasing influence of Beijing. However, it does not look like the United States, and Japan can threaten China's position as a leader in 5G technology development, or at least that is how the Chinese side sees the situation. The number of Chinese users connected to 5G networks is growing at a rapid pace. Forecasts predict that Chinese technology companies will gain 739 million 5G subscribers by 2025, corresponding to an almost 40% share of the global 5G market. China has a competitive advantage with its extensive presence in the global 5G infrastructure as well as a vast domestic market for these solutions<sup>18</sup>.

One should also bear in mind the cooperation platforms introduced by the previous US administration, which could become a basis of a future partnership on digital currency development, providing that the current government is willing to develop them further.

One of the most promising exchanges is the US-Japan Policy Cooperation Dialogue on the Internet Economy. In this platform, the countries discuss technologies that would ensure an open, interoperable, reliable, and secure Internet. The initiative focuses on advancing Artificial Intelligence, data distribution, as well as 5G and IoT projects in the Asia-Pacific region<sup>19</sup>. Another important forum is The Japan-US Strategic Digital Economy Partnership

(JUSDEP), developed in 2019 as part of the Free and Open Indo-Pacific initiative. The project focuses on establishing cooperation in the energy sector, infrastructure, and the development of the digital sector. In the digital cooperation section, the initiative focuses on promoting joint initiatives in the Asia-Pacific region, focusing on digital infrastructure projects, cybersecurity, smart cities and protecting cross-border privacy and information security<sup>20</sup>. Both platforms are important examples of U.S.-Japan cooperation, which supports digital projects with other members of the Asia-Pacific community such as ASEAN and Australia.

## CONCLUSIONS

Unfortunately, none of the digital cooperation platforms introduced by the administrations of Joe Biden and Donald Trump mention cooperation on developing joint digital currency projects. Are the United States and Japan serious about countering China in the global digital race? If this is the case than these partnerships should be extended to other countries from the Asia-Pacific region, which are already cooperating with the US. Similar cooperation may be needed in the case of digital currencies. Frederick Kempe (2021), president of the Atlantic Council, said that *"The US can still win this contest if it not only quickly develops a digital dollar, but collaborates on the creation of a digital euro, a digital pound, and a digital yen. The total firepower of these currencies would close the innovation gap quickly."*<sup>21</sup> He is right to say that working together with allies may be the only way to catch up with China and promote an open, interoperable, reliable, and secure digital economy in the Asia-Pacific.

The lack of discussion on digital currency cooperation stems mainly from the fact that key institutions in the United States and Japan (FED and BOJ) have not yet specified their final approach towards introducing CBDCs. Both governments remain cautious about moving forward with their digital currency projects. Other reasons for this reticence come from the differences between the banking systems in Japan and the United States as well as the reservations of members from the banking and financial sectors regarding the idea of developing an alternative payment system. However, these obstacles should not prevent the two countries from developing joint digital currency projects in the long term.



**Recent developments have shown that the United States government is one step closer to accepting the idea of launching a CBDC.**

Although the Japanese government remains sceptical about the project, the United States may convince Japanese decision-makers to accelerate the process of research and development. The United States could also benefit greatly from cooperation with Japan in the process of developing its own digital currency. Based on previous experiences with the booming cryptocurrency market, the Japanese government has been dealing with the problem of monitoring and securing numerous cases of currency theft and a large number of cases involving cryptocurrencies in criminal activities. International pressure from the G7 has forced the Japanese government to introduce stricter regulations of digital currency exchange platforms. The US administration could learn from the Japanese experience and apply some of these solutions to develop a secure digital dollar.

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